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SUBJECT: ENERGY'S ECONOMIC AND POLITICAL IMPACT ON THE UK

¶1. (SBU) Summary. The UK faces two major energy challenges: a rise in fuel poverty and decreasing domestic oil and gas production. Current estimates put the number of households suffering from fuel poverty at 4.5 million according to the National Energy Action, an independent charity. Additionally, the UK is going through a major transformation from virtual self sufficiency in terms of natural gas production to importing 80-90% of natural gas supplies by 2020 according to Department for Business, Enterprise, and Regulatory Reform (BERR) projections. The British government is taking steps to address these issues with mixed results - and sometime political backlash - ensuring that energy will remain in the political spotlight. End Summary.

Rising Fuel Costs

¶2. (U) Rising fuel costs have plagued the UK, like most countries, sending two million households into fuel poverty since 2005. The British government developed a strategy in 2001 to eradicate fuel poverty in vulnerable households, defined as those with elderly or children, by 2010, and all households throughout the UK by 2018. A household is considered in fuel poverty if it spends more than 10% of its income on fuel to maintain a satisfactory heating regime according to BERR. Gas and electricity costs are increasingly becoming a larger part of household budgets. While wages in the UK have increased 3.9% in the first quarter of 2008, energy costs have far outpaced wages. The winter of 2008 saw domestic energy prices rise across all six main gas and electricity providers with EDF Energy and Npower leading the hikes with rate increases of 27%. In June, independent energy expert John Hall of John Hall Associates warned that domestic consumers could see a 38% increase in energy costs in 2009. On July 25, EDF announced it would raise gas prices 22%, and on July 31 British Gas followed suit raising rates 35%. The other four providers are expected to announce rate hikes in the coming week.

Domestic Gas and Oil Production Falls

¶3. (U) While energy costs are rising, domestic oil and gas production declined over the last decade as the UK has moved from a net exporter of fuel to a net importer. BERR predicts North Sea oil production will fall from 60-80 million tons in 2008 to 45-65 tons by 2013. Gas production is also predicted to fall from 60-75 billion cubic meters in 2008 to 40-60 billion cubic meters in 2013. At the same time, demand for oil is expected to rise to over 90 million tons by 2013 and demand for gas is expected to exceed 90 million tons of oil equivalent, far outstripping domestic production.

¶4. (U) The North Sea provides the majority of all domestic oil and gas production. The development of two new fields in the North Sea, West Don and Don South West, with an estimated 25 billion barrels of oil still to be produced, have raised production hopes for the North Sea oil fields. However, the remaining oil is difficult and costly to tap into, requiring large technological investments. BERR acknowledges that the UK will become increasingly dependent upon

imports of foreign gas and oil. The UK imported .7 million tons of oil and imported 338 million cubic meters of natural gas in 2007, 38.5% more than in 2006.

British Government Efforts

¶15. (U) The Labour government's 2001 plan to tackle fuel poverty included increasing the use of smart metering, grants to individuals to make energy efficient home repairs under the Warm Front program, and working with energy suppliers to offer discounts for low-income households. Such improvements could significantly reduce residential energy demands, as many homes across the UK are not energy efficient. BERR has since acknowledged the government will be unable to keep its promise and estimates that 1.2 million vulnerable households will be fuel poor in 2010. Prime Minister Brown called for information sharing among energy suppliers, consumers and the government to identify and help vulnerable families in his May 28, 2008 editorial in the Guardian. Brown is now working with energy providers to develop new measures this autumn to provide relief to fuel poor households. He is not expected to call for a windfall tax, to the dismay of some Labour MPs.

¶16. (U) Additionally, the British government is seeking to increase energy sustainability and reduce the UK's carbon output 23-33 million tons by 2020 through investments in nuclear and renewable energy sources. There are currently 19 operating reactors at 10 nuclear power stations; all but one will close by 2023. Nuclear provides 19% of the nation's electricity supply. Brown has urged Parliament to pass the Planning Bill, currently in the House of Lords, to improve the process for developing nuclear plants and other major infrastructure projects by creating a commission

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responsible for streamlining procedures. The investment in new nuclear plants could represent BPS 20 billion (USD 40 B) in investment and create up to 100,000 new jobs for British citizens. The British Government, however, has vowed to not grant any subsidies in this process. Hutton stated there will be, "no politically-imposed ceilings on the contribution from nuclear in the UK's energy mix. The market - not ministers - should be free to determine the precise mix."

Two Pence Tax U-turn

¶17. (U) In 2007, HM Treasury planned a series of three two-pence (four cents) per liter increases in the fuel duty. The first two-pence increase came in autumn 2007 with the second scheduled for April 2008, and a third in 2009. The government postponed the April 2008 increase until October 2008 due to political pressure in light of rising fuel prices. However, on July 16, the week before the Glasgow East by-election, Chancellor Darling announced that the two-pence fuel duty rise would be further postponed, with future decisions on fuel duties to be made during next spring's budget. Tory leader David Cameron attacked the move as purely political, intended to increase Labour support before the by-election, which Labour subsequently lost to the Scottish National Party.

Fuel Protests

¶18. (U) As is the case across Europe, the UK has seen a number of fuel protests since summer began. The most recent occurred July 2 with 230 trucks parading past Westminster disrupting London traffic. The protest was organized to coincide with major industry meetings in London including the Motor Transport Awards. Truckers are lobbying for an "Essential User Rebate" which would permit discounted fuel prices for their work. The rebate would be similar to the existing discount given to public transportation. The event also served to pressure the government to scrap the scheduled two-pence fuel duty increase. A similar protest took place in London in May and in Manchester on June 5.

¶19. (SBU) Comment: Energy costs and planning for future energy needs

will continue to be pressing political and economic issues in the UK. The pain of current high prices is exacerbated by the current housing market crash, the credit crunch, and other downturns in economic growth. The British government understands the political need to take action to alleviate the pressures of rising energy costs on UK voters. But the current plan outlined by the Labour government addressing fuel poverty will not, by the government's own admission, be able to achieve its stated fuel-poverty goals, nor can the government assure that the focus on nuclear investment will pay off. The current economic situation should continue to spur innovation and investment in alternative fuel sources including nuclear, but the solution - and an end to the current pocketbook pain UK energy consumers are feeling -- is most likely long term, a bad political reality for the Brown Government.

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